



COUNCIL REPORT

This is a progress report to the City Council of San Jose. This report summarizes 10 key themes from stakeholder sessions and identifies what strategies other employers throughout the nation are considering in addressing their liability.

Key Themes from Stakeholder Sessions

Preface

Below are ten of the key themes communicated to the facilitators. Full summaries of the notes taken from each stakeholder meeting are attached.

Key Themes from Stakeholder Sessions

All of the Stakeholder listening sessions were extremely rich with very positive ideas as well as strong cautions. The following is a brief summary of the ideas and concerns we received:

1. Do not require retirees to disproportionately solve retiree healthcare liabilities.

While this theme was heard very consistently from retirees, employees and other stakeholders also voiced concern regarding retirees having to face reductions based on changes to their benefits. They felt they were the least equipped, because of their fixed income, to assume broad responsibility for major changes in retiree coverage or co-pays. A significant number of retirees, as well as some current employees pointed out that retirees are one of the least represented groups, and as a result, retirees should not shoulder a disproportionate share of the retiree healthcare burden. Retirees frequently comment that they had made concessions in both wages and benefits during their careers precisely to receive coverage in retirement. They based their retirement plans on certain assumptions and felt that it was unfair to change the benefits after they had retired, and had few options to address the changes. In general, they stated this would create undue hardships. The key theme from many stakeholder groups, in this area, was that retirees were provided a promised benefit as part of their working-career contract, and they are not interested in seeing the City/Council break that promise regardless of GASB's implications.

2. Stakeholders realize some changes must occur.



Background materials were distributed to stakeholders in advance of the stakeholder sessions. The sessions were also structured to provide an educational and active interchange. Because of this information sharing, participants were willing to focus on possible solutions instead of emphasizing unfairness, GASB's applicability to San Jose, or tardiness in the City's acting or wasteful spending for example. In the sessions, stakeholders clearly indicated that they want to participate in evaluating and recommending solutions. Stakeholders in all the sessions expressed interest in prevention and wellness programs, more flexibility in contribution tiers, and the possibility of a temporary waiver of contributions. Stakeholders are willing to consider improvements, so thoughtful changes to the retiree healthcare plan may be acceptable as long as the basic security is preserved. In almost all sessions, stakeholders recommended exploring plan design and contribution changes for prospective workers. They were disappointed to learn that strategies exclusively focused on prospective workers would create little initial savings. There is some acceptance that the active employees' plan may have to change, and that more changes are acceptable in the actives' plan than in the retiree plan. Stakeholders realize active employees are still earning a paycheck while retirees are on a fixed income which does not keep pace with health cost increases. However, actives maintain the belief that it would be inequitable for the City to change their healthcare benefits without changing the retiree plan as well.

3. It is essential to control cost!

Stakeholders were very passionate about and savvy in realizing a lower level of contributions (both for the City and themselves) is possible if future cost increases are lower than in the past. The 40% increase in employee contributions (effective July 1, 2008) added to their strong support of controlling costs. Regardless of the motivation, stakeholders made excellent suggestions about how costs can be better controlled than they are at present. If implemented, many of the stakeholders' suggestions could reduce both City and employee costs. The attached stakeholder session notes provide details on suggested cost controls, but a few of the ideas are highlighted below:

- a. Educate patients about how to become better (more cost-effective) users of health care. Health plan providers offer many aids people can use to be wiser consumers. The City should communicate these regularly.
- b. Work harder to find more effective cost controls. Stakeholders strongly believe there are more effective actions to control costs than are being used now.
- c. Audit the effectiveness of current providers and require / monitor improved performance when / if deficiencies are revealed.



- d. Investigate individual account plans. These accounts would be perceived as “my money” instead of “other peoples’ money” and as a result patients might be more prudent in their health care purchases.

4. Seek innovative solutions rather than blindly shifting costs.

Stakeholder session participants strongly opposed shifting costs to active employees (and / or retirees) as the solution to funding for future retiree health costs. Participants are confident there are large, possibly untapped, resources available in the form of innovative and creative ways to control costs and better fund the retiree healthcare liability. Their concern about cost shifting was the expenditure of energies and time that could otherwise be directed to solve the challenges in creative ways. The stakeholder session notes are replete with creative ideas offered by participants, and the following are just a few examples:

- a. Investigate a waiver system so spouses with coverage elsewhere and retirees who may work elsewhere could take advantage of the other sources of coverage without losing their eligibility for City coverage if the other coverage becomes unavailable.
- b. Adjust pension contributions to provide a larger share to healthcare funding.
- c. Implement retiree health savings accounts so employees can accumulate assets for retiree health expenses.
- d. Investigate the use of Medicare Advantage and Medicare Supplement to reduce retiree health cost liabilities and out-of-pocket expenses.
- e. In advance, pre-designate “excess” pension fund earnings to be transferred to reduce retiree health liabilities.
- f. Investigate palliative care and other forms of support for terminally ill patients. These options could control costs and improve the quality of life experienced by dying patients and their families.
- g. Consider on-site minor treatment programs utilizing a nurse practitioner / physician assistant. Provide pharmacist consultation about more effective use of medications (especially with diabetics).
- h. Investigate rolling over the value of unused sick leave into individual accounts.

5. A collaborative approach to problem solving is needed.

Stakeholders realize the best solutions result from collaborative rather than adversarial efforts. Facilitating a jointly agreeable direction is preferable. Many union representatives agree that given the right circumstances, trust can be rebuilt using a collaborative approach to reduce retiree health costs as well as other challenges. However, they also caution that messages about retiree healthcare need to be better aligned in order to increase the likelihood of favorable collaborative consideration of solutions. Union representative stakeholders especially voiced concerns about the mixed



messages that are sent (often via the media) about shared burdens, “rich” benefits, over-benefited public workers, etc. (See the CLA stakeholder session notes from December 10 for more details).

The stakeholder notes offer many ideas, but one early step could be changing contributions for actives (and the single / family choice required at retirement) to increase flexibility and equitability in retirement options. In addition, stakeholders mentioned that more use of the Benefits Review Forum would be a good example of more effective planning. Numerous stakeholder groups asked for more “back-to-basics” education about how plans work, and differences between active and retiree plans.

6. Find a way to phase in full funding.

Stakeholders generally agree that the advantages of eventual full funding outweigh the pain associated with accomplishing full funding. Consequently, instead of trying to fully fund the ARC immediately, or else ignoring the obligation as the only other alternative, a better middle ground is to adopt a phased-in approach. In a phased-in approach, stakeholders say funding should be gradually ramped up to full funding over time (possibly three to five years or longer). This would give cost controls an opportunity to work and likely allow the higher actuarial interest rate assumption associated with planned and definite movement toward full funding of the ARC to work on the City’s and employees’ behalf.

7. Reduce demand for health care by improving health.

Stakeholders frequently mentioned use of prevention, risk-reduction, and wellness programs to improve actives’ and retirees’ individual health. Stakeholders recognized that better health is not only better for individuals but also helps lower costs.

Based on the stakeholder feedback, the combination of a comprehensive health improvement program and reasonable cost controls would be much more cost-effective and acceptable to participants than either alone. Stakeholders added that the results of the health improvement programs will be much greater if there is strong, visible support from the City and if rewards are associated with positive changes and improved healthy behaviors.

One of the many examples of a very good suggestion in the notes is to expand the City’s current Employee Assistance Program to include classes like Weight Watchers, smoking cessation, fitness opportunities, etc. Similarly, a diabetes-reduction program and chronic disease management/improvement programs like asthma, COPD, pain control,



heart failure, and migraines could mitigate health risks. Participants would welcome these kinds of strategies and believe they are likely to be cost effective over time.

Stakeholders added that communication about currently available health plan resources would be very valuable. There was considerable interest expressed in several stakeholder meetings about the concept of rewarding good health status by offering rewards for health improvement. In addition, the good and widespread potential for informed self-care was mentioned repeatedly because participants recognize that informed self-care helps patients use providers appropriately.

8. Stakeholders are very interested and wish to stay engaged.

A key step following the stakeholder sessions is to comply with the participants' often-voiced request that they continue to be informed and involved in the decision-making process. Stakeholders suggested numerous educational sessions including in-depth information discussions from actuaries, health plans, and bonding organizations. Participants are willing to serve on committees or other working groups to consider and evaluate options. They believe it is important to hold another round of sessions to allow their input on specific possible actions before the Mayor and City Council make final decisions.

As another engagement strategy, stakeholders have suggested plan participants be given the opportunity to make better informed choices in their plans (see # 9 below). Stakeholders would welcome an interactive "choice making consequences model" that would outline their options and the results of selecting any particular option. Employees could use the interactive model to test their tolerance for risk-bearing in their own financial situations.

9. Create more flexibility and choices in health care options.

Participants strongly supported individual retiree health savings accounts to assist in, or completely fund retiree healthcare. Similarly, some current arrangements are seen as inequitable and inflexible, and many sensible suggestions about how to remedy these difficulties were offered by stakeholders. The following are examples:

- a. Stakeholders do not view imposed solutions as solutions at all. They desire the opportunity to make choices and thus "own" their portion of the solution that best suits their circumstances.
- b. Even making choices among a broader array of plans selected and offered by the City is not as desirable as participants having the opportunity to select other types of plans rapidly becoming available in the



individual coverage market place (e.g. high-low deductible plans or catastrophic-only coverage plans).

10. Proceed Cautiously and Plan Thoroughly.

Stakeholders said in many ways that consideration of possible solutions and planning for actions needs to be extremely thorough and deliberate. They added that much education and updating throughout the process would be beneficial to the process as well as to stakeholders. Stakeholders have said they are not in favor of “fast and wrong.” They conclude that these challenges did not develop overnight, and because of the magnitude and importance, no one should try to solve them overnight either.

Key Themes from Other Employer Actions

The City is among the first group of employers to come under GASB regulations. Employers become responsible for GASB requirements on different dates based on financial revenue.¹ Employers above \$100 million, such as the City of San José, became responsible in 2007. As a result, most public sector employers throughout the country are exploring but have not adopted strategies to address GASB regulations. Even for those few employers who have actually initiated changes, there has been insufficient time to evaluate the effectiveness of those strategies.

We have utilized information from several recent national reports summarizing what strategies are being considered by public employers throughout the country (see bibliography for current reports represented). These are by no means exhaustive as employer actions are still evolutionary. We have posted these reports on the City’s internet and we have utilized these reports to identify the critical strategies that states, counties and cities are considering and, in a few cases, implementing. The National Center for the Study of Counties (NCSC) in cooperation with the National Association of Counties (NACO) recently published their 2007 assessment of county responses to GASB. In this report, it is explained that Sonoma County will be transitioning from payment of 85% of retiree health plan costs to 85% of the lowest cost plan (Kaiser).² A survey of key employers, critical from the City’s perspective, will provide a more local assessment of what neighboring employers are considering.

1. Employers are slow to identify and select a Trust vehicle for GASB funds.

¹ Phase 1 governments with total revenues over \$100 million became effective for fiscal years after December 15, 2006. Phase 2 governments with total revenues between \$10 million and \$100 million are effective the fiscal year after December 15, 2007. Phase 3 governments with less than \$10 million are effective the fiscal year after December 15, 2008. *Government Accounting Standards Board. “Status of Statement No. 45. www.gasb.org*

² The Implementation of GASB 45: Case Study of 15 Counties, Dr. Paula Sanford, National Center for the Study of Counties, p. 56



GASB establishes the standard of creating a trust for the exclusive use of retiree health funding to assure that benefits set aside cannot be used for other purposes. While there are numerous trust vehicles where assets may be accumulated to pay retiree health expenses (Voluntary Employees Beneficiary Association (VEBA) Trust, Integral Trust, 401(h) Trust, Health Savings Account and Health Reimbursement Account), few employers have made final decisions regarding the trust instrument they will use or developed strategies to address these new requirements. As an example, at the end of fiscal year 2006, only six states---Arizona, North Dakota, Ohio, Oregon, Utah and Wisconsin---were on track to have fully funded their non-pension obligations during the next 30 years. Of the five largest states---California, Texas, New York, Florida and Illinois---none had put aside money for non-pension benefits.³ Employers are also questioning the appropriateness of an irrevocable trust and those who are implementing trust vehicles are including language that provides access to trust assets in the event of federal health insurance.

2. Employers are adopting varied strategies for funding benefits.

Most employers have decided to continue to review full funding requirements versus partial funding as their initial strategy. A number of employers have met with their local bond rating agencies to discuss how various funding strategies will be viewed by bond raters. Fairfax County, Virginia is a good example of an employer that met with their bond raters. What they heard was that it was not critical to fund the total ARC but that it was critical to: 1) enact a fund plan, 2) demonstrate efforts to control costs and 3) demonstrate a track record of adhering to key timetables that were established.⁴ Prominent national bond rating agencies like Moody's, and Standard and Poor's, have also stated that it is less critical to eliminate the retiree health liability entirely and more important to have a plan on how funding will be accomplished. Through meetings with credit raters, the City is likely to have a clearer picture of what strategies, short of full funding, may be used with little risk of creating an adverse bond rating.

It is important to emphasize that the more the City funds its liability the more it can use investment returns which will reduce long-term City and employee contributions. The City and County of San Francisco recently reached tentative agreement with its labor organizations to change the retiree health eligibility criteria for employees in exchange for pension enhancements⁵. This strategy simultaneously reduces the retiree health cost liability and increases the pension liability. Because the pension plan's assets are larger, investment growth can be

³ Promises with a Price: Public Sector Retirement Benefits, PEW Center on the States, Executive Summary, p.7

⁴ The Implementation of GASB 45: Case Study of 15 Counties, Dr. Paula Sanford, National Center for the Study of Counties, p. 37

⁵ The proposed Charter Amendment going before voters in June would change the eligibility requirement for retiree health from 5 to 20 years of service in exchange for increasing the pension benefit from 2% @ 60 to 2.3% @ 60.



utilized to fund the increased pension liability more effectively than it could for retiree health benefits (where assets are insufficient to generate significant return).

3. Employers are not pursuing bond options.

On March 2, 2007 the Executive Board of the Government Finance Officers Association issued a Recommended Practice brief which concluded that governments “should exercise considerable caution when contemplating the possibility of issuing OPEB bonds.” Partly because of the current market status and the question of whether investment returns can supersede bond returns and partly because of the uncertainty of future medical costs, most public sector employers are not currently utilizing bonds to address their retiree health cost liability.

Municipal governments are able to include salary and benefit expenses for State and Federal mandated programs or grants. While it appears that most federal and state agencies will reimburse salaries and benefits including pension and OPEB liabilities, it is less clear that they will allow bond repayment as an expense. California’s Public Post-Employment Benefits Commission’s fourth recommendation counsels employers to carefully research bonds before pursuing bond strategies to reduce retiree health cost liability.⁶

4. Employers are determining their legal parameters for strategies.

How employers have communicated their retiree health benefits is critical in determining what latitude they have to modify benefits. Some employers have communicated very clearly over time that their benefit is not promised beyond current fiscal years and have therefore concluded that they may alter benefits not only for prospective employees but for current employees and even retirees. Based on the analysis performed by Jones Day for the City of San Jose, the City may modify benefits for prospective employees but may not change benefits for current retirees or active employees.

5. Employers are exploring design changes and wellness programs.

Employers are aggressively pursuing a wide array of design changes, risk reduction and well programs to address their retiree health cost liability. The National Center for the Study of Counties indicated that many counties are “extending the required years of service to qualify for OPEBs.”⁷ While many of

⁶ “Any employer considering the use of OPEB bonds should fully understand, and make public, the potential risks they bring. Such risks include: shifting costs to future generations, converting a future estimated OPEB liability into fixed indebtedness, and the uncertainty concerning continued federal cost sharing for debt service on such a bond.”

⁷ The Implementation of GASB 45: Case Study of 15 Counties, Dr. Paula Sanford, National Center for the Study of Counties, p. 16



these organizations use 5 or 10 years for pension benefits, they are increasingly using 15-20 years for retiree health benefits.

Employers are almost universally seeking improvement of health as a cornerstone for their strategies in reaction to GASB regulations. In the counties highlighted in the NCSA study, wellness program and risk reduction interventions were frequently considered to help control future health care costs. These programs focus on high risk categories (e.g. cardiovascular disease, diabetes) by using health risk assessments or health plan claims utilization data to determine where high costs may be reduced through programs.

6. Employers are exploring Retiree Health Savings Accounts.

Retiree Health Savings Accounts allow the employer and employee to make contributions (which are not considered a retiree health cost liability) to individual retiree health savings accounts. These contributions are made on a pre-tax basis. Investment gains in these individual accounts are not taxable and so long as assets are used for eligible medical expenses, the receipt of funds from accounts is also not taxable. For example, the County of San Bernardino has used a VEBA for several years to accumulate benefits for retiree health care costs.

Most employers are looking to introduce these individual accounts in addition to, or as a replacement for, current retiree health benefits for new employees. Some employers are also exploring the negotiation of these benefits for current employees in exchange for a reduction in retiree health cost liability through other options (e.g. modification of eligibility criteria, reduction in defined benefit, changes in health plan design or premium payments). Finally, many employers are considering these accounts exclusively for prospective employees as an alternative to continuing to fund defined retiree health benefits. There are currently five models employers may use.⁸ It is critical for employers to determine which model best meets its need as all models share the common

⁸ The five models are:

- Health Savings Account (which requires the establishment of a High Deductible health Plan (HDHP) and is the only option of the five to permit employee pre-tax contributions).
- 401(h) Plan (which if combined with a pension plan cannot exceed 25% of annual pension contributions).
- Health Reimbursement Account
- Voluntary Employee Beneficiary Association (VEBA) Plan which requires the establishment of an oversight Board usually a combined labor-management Board.
- Section 115 Integral Trust

Each of the five models permits pre-tax employer contributions for employees (retirees are not eligible for participation). All models permit un-taxed investment growth and if used to pay eligible expenses in retirement (premiums, co-pays, 213 expenses) are non-taxed. The options permit eligible dependents (spouse, underage dependents) to continue to pay expenses upon the death of the participant but if there are no eligible dependents then funds revert to the plan or other participants in the plan.



characteristics of avoiding additional retiree health cost liability by providing a tax-free investment, growth and expenditure of assets for retiree health expenses.



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